State of New York
Office of the State Comptroller
Division of Management Audit and State Financial Services

MORTGAGE LOAN ENFORCEMENT AND ADMINISTRATION CORPORATION

ADMINISTRATION OF DEBT SERVICE FOR MITCHELL-LAMA PROJECTS

REPORT 97-S-33

H. Carl McCall

Comptroller

State of New York
Office of the State Comptroller

Division of Management Audit and
State Financial Services

Report 97-S-33

Mr. Larry Sutton
General Counsel
New York State Mortgage Loan Enforcement
and Administration Corporation
633 Third Avenue
New York, NY 10017-6754

Dear Mr. Sutton:

The following is our report on the Mortgage Loan Enforcement and Administration Corporation's administration of debt service for Mitchell-Lama projects.

This audit was performed pursuant to the State Comptroller's authority as set forth in Article X, Section 5 of the State Constitution and Article II, Section 8 of the State Finance Law. Major contributors to this report are listed in Appendix A.

Office of the State Comptroller
Division of Management Audit
and State Financial Services

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Executive Summary

Mortgage Loan Enforcement and Administration Corporation
Administration of Debt Service for Mitchell-Lama Projects

Scope of Audit

During the late 1960s and early 1970s, the Urban Development Corporation (UDC), a public benefit corporation created by the State Legislature, issued bonds to finance the development of 113 housing projects (projects) throughout the State for low-income and middle-income families. The projects were developed by private housing companies (companies) in accordance with provisions of the New York State Private Housing Finance Law, known as the Mitchell-Lama Law. The companies were allowed 40 years to repay UDC both the principal and interest on their loans. Many of the projects also received subsidies from the Federal government. Of the original 113 projects, 108 remained in the program as of December 1997.

In the mid-1970s, it became clear that many of the UDC projects were not financially viable; the cash flow from rent receipts was not enough to cover operating expenses and debt services. As a result, these projects had significant arrearage in debt service. In response, UDC created the Mortgage Loan Enforcement and Administration Corporation (MLC) in 1979 as a subsidiary corporation that would service the housing mortgage portfolio by billing and collecting mortgage debt. In addition, MLC can negotiate agreements with the companies to reschedule past-due and current debt and can advance additional funds. The mission of MLC and its staff of 13 includes improving debt service collections, monitoring projects and maintaining and improving projects' financial and physical condition.

Our audit addressed the following questions about the administration of debt service by MLC for the period July 1, 1992 through March 31, 1998:

- Has MLC been successful in reducing project arrearage?
- Was MLC properly advancing additional funds to projects and was MLC adequately monitoring the use of these funds?
- Did MLC provide effective monitoring of the physical conditions of the projects?
- Did MLC identify and collect excess amounts of cash being held by the projects?

Audit Observations and Conclusions

Staffing limitations have hindered MLC's ability to implement certain control procedures. In December 1996, MLC contracted with Greystone Servicing Corporation (Greystone) to gradually assume responsibility for most of MLC's operations. We believe our audit results should be helpful to MLC in directing Greystone to strengthen operational controls.

We noted that without subsidies, 80 of the projects in MLC's portfolio would not have enough revenues to pay their operating expenses and to fund their debt service obligations. In addition, MLC continues to authorize additional funding to the projects in the form of loans and advances. As a result, the debt load of the projects in MLC's portfolio continues to increase. We believe that MLC should develop short and long range strategic plans that address growing debt arrearage as well as the role for workout agreements and foreclosures. (See pp. 5-8)

When we examined the loans made to sampled projects, we found a lack of evidence and documentation that would demonstrate that the funds were needed. In addition, we found indications that MLC did not always ensure the projects were inspected before the loans were authorized. (See pp. 13-17)

MLC had no guidelines for its inspection of the physical condition of the projects; 72 of the 108 projects had not been inspected during the last year of our audit period. Also, in two instances where MLC inspectors found hazardous conditions, there was no follow-up to verify implementation of the corrective steps that reportedly had been taken. (See pp. 19-22)

MLC analyzes project financial data to determine whether the projects have excess funds that could be used to pay down past-due amounts. However, we found no documentation indicating the procedures that MLC follows in performing such an analysis or collecting the excess funds that were identified. MLC staff have not been consistent in the methodologies they use to determine the availability of excess cash and they do not analyze the excess cash possibilities for all projects in arrears. (See pp. 23-26)

Comments of MLC Officials

MLC officials disagree with several of our findings and conclusions and do not specifically respond to our recommendations.

Contents

Introduction

Background

During the late 1960s and the early 1970s, in accordance with provisions in Article 2 of the New York State Private Housing Finance Law, known as the Mitchell-Lama Law, the New York State Urban Development Corporation (UDC) financed the development of 113 housing projects (projects) for low-income and middle-income residents. Initially funded by the proceeds of bonds issued by UDC, these projects were to be built and operated throughout the State by housing companies (companies) organized for that purpose. The $1.1 billion of loans financing the construction were secured by liens. The Empire State Development Corporation (ESDC) assumed UDC's role in 1995. Currently, 108 projects, containing 31,000 apartment units, remain in this portfolio. As of March 31, 1997, approximately 28,500 of the apartments were occupied; occupancy rates at each project ranged from 28 percent to 100 percent. Under Section 236(B) of the National Housing Act of 1934, interest payments are reduced for 98 projects through subsidies from the U.S. Department of Housing and Urban Development (HUD). Currently, these annual subsidies exceed $58 million.

In 1975, after UDC was unable to make timely payments on its debt obligations and could not finance completion of some of the projects, the State created the Project Finance Agency (PFA). PFA received State appropriations of $198.1 million and issued bonds and notes for $280 million, using the proceeds to purchase 26 Section 236(B) subsidized mortgages from UDC.

During the 1970s, as it became increasingly apparent that rent receipts for many UDC projects were insufficient to cover both operating expenses and debt service, an aggressive program to stabilize the UDC and PFA mortgage portfolios was initiated. In 1979, UDC organized the Mortgage Loan Enforcement and Administration Corporation (MLC) as a subsidiary corporation to service the UDC and PFA portfolios, retaining 51 percent of the ownership and assigning the remaining 49 percent ownership to PFA. MLC's mission includes improving debt service collections, monitoring projects and maintaining and improving projects' financial and physical condition. MLC's service responsibilities include the preparation of billing statements and the monitoring of account status. MLC is also responsible for negotiating workout agreements with projects, initiating foreclosure proceedings, inspecting projects, providing additional financing as specified in Section 32 of the mortgage agreement, and authorizing other loans and advances to projects from various sources.

MLC, which employs a staff of 13, contracted in December 1996 with Greystone Servicing Corporation (Greystone) to service its mortgage portfolio. Greystone is expected to assume MLC's data processing and project inspection functions, but this transfer had not been completed as of the end of our field work.

Audit Scope, Objectives, and Methodology

We audited MLC's administration of debt service for the projects in its portfolio for the period of July 1, 1992 through March 31, 1998. The objectives of our performance audit were to determine whether MLC was successfully stabilizing the financial conditions of the projects, properly advancing additional funds to projects, adequately monitoring the use of advance funds, effectively monitoring the physical conditions of projects and was identifying and collecting excess project cash. To accomplish our objectives, we interviewed MLC officials and reviewed their records, including those for judgmentally-selected samples of projects.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we plan and perform our audit to adequately assess those operations of MLC which are included within our audit scope. Further, these standards require that we understand MLC's internal control structure and its compliance with those laws, rules and regulations that are relevant to the operations which are included within our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments, and decisions made by management. We believe that our audit provides a reasonable basis for our findings, conclusions, and recommendations.

We use a risk based approach when selecting activities for an audit. We therefore focus our audit efforts on those operations that have been identified through a preliminary survey as having the greatest probability for needing improvement. Consequently, by design, we use finite audit resources to identify where and how improvements can be made. Thus, little effort is devoted to reviewing operations that may be relatively efficient or effective. As a result, our audit reports are prepared on an "exception basis." This report, therefore, highlights those areas needing improvement and does not address activities that may be functioning properly.

Response of MLC Officials to Audit

A draft copy of this report was provided to MLC officials for their review and comment. Their comments have been considered in the preparation of this report and are included as Appendix B.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the General Counsel of the Mortgage Loan Enforcement and Administration Corporation shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

Management of Portfolio

For many of the projects covered by the MLC portfolio, rental revenue is not sufficient to meet operating expenses and debt service payment requirements. According to MLC's statistics for the fiscal year ended March 31, 1997, for the 108 projects in MLC's portfolio, net operating income before debt service obligation was $26.9 million. For 83 of the projects, net operating income totaled more than $30.1 million, while the other 25 projects had operating losses totaling $3.2 million. The projects were obligated to make annual debt service payments of nearly $41.8 million on the original mortgage debt. This exceeds their combined net operating income by almost $15 million, without consideration for past-due amounts or amounts due for additional advances. Without HUD subsidies, 80 of the projects generate insufficient revenue to meet their current obligations on their original mortgage. No debt service payments were made for 15 of these projects during the fiscal year that ended on March 31, 1997. In response to our observations, MLC officials stated that they are currently providing operating funds for no more than eight projects. Officials arrived at this conclusion by including the HUD subsidies in the income figures for the projects.

Response of MLC Officials to Audit: In response to our draft report, MLC officials stated that it was never anticipated that projects receiving subsidies would generate sufficient revenue to pay operating expenses and debt service obligations without such subsidies. They pointed out that only the housing company portion of debt service, or about 20 percent of the annual debt service requirement, is not being paid for the 15 projects cited.

Auditor Comments: Our point in presenting this information is to provide pertinent background information about the status of the portfolio. In addition, it should be noted that the subsidies are for a 40 year period.

Restructuring Agreements

MLC can negotiate repayment agreements (workout agreements) with projects that are unable to meet their existing mortgage payments. In addition, MLC can initiate foreclosure proceedings against projects that default on their loans. Workout agreements usually provide for the recapitalization of debt arrears into new notes, contributions of additional capital and the creation of new payment schedules.

Since its inception in 1979, MLC has entered into 80 workout agreements involving 66 projects. However, these efforts have not had any overall success in reducing project arrearage. Projects do not pay their debt

service obligations and continue to borrow. For example, if the projects had made all required payments on a timely basis on the original mortgage loans, which totaled $1.1 billion, the total debt outstanding would have been $1.05 billion on December 31, 1992 and would have decreased to $999 million by December 31, 1996. However, the actual outstanding debt now exceeds the original amounts mortgaged and it is continuing to increase, from $1.438 billion on December 31, 1992, to $1.526 billion on December 31, 1997. We reviewed the six projects from MLC's portfolio that had current workout agreements but had made no debt service payments during the fiscal year ended March 31, 1997. Four of the six projects had obtained prior workout agreements with MLC.

Pursuant to these six current agreements, the housing company owners committed to contributing $4.4 million toward repairs that were expected to cost a total of $5.3 million for the projects. However, three of the six agreements permitted interest due to accrue until maturity if the projects were unable to pay. The other three allowed the projects to begin making small payments, then progressively-larger payments at a later date, although there was no basis or analysis conducted for envisioning that the projects would have the financial resources to meet accelerated payment provisions.

MLC officials indicated that, in many instances, they do not measure a workout agreement's success by a resulting reduction in arrearage. For example, officials consider workout agreements to be successful if funds are obtained for needed repairs and improvements. MLC officials also explained that they have very little power to enforce mortgage payment requirements, even though they have the prerogative to foreclose. Concerning foreclosure, MLC officials state that they are reluctant to take this step because they believe that the projects would sell for substantially less than the outstanding balances of their principal mortgages and would have no market value outside the Mitchell-Lama program. Therefore, if MLC forecloses, it might be obligated to hold and manage the properties, a burden MLC officials are reluctant to undertake. MLC officials also pointed out some of the projects with arrearage are located in economically-depressed areas, which often have a housing surplus that contributes to high vacancy rates. In other instances, projects were constructed with electric heating systems which were costly to operate and consumed a large portion of the operating budgets.

We recognize that reduction in arrearage is not the only possible benefit of workout agreements and that many difficult factors are undermining the financial stability of projects. Nevertheless, it can not be overlooked that debt arrearage continues to grow despite the use of workout agreements.

We believe MLC should develop a strategic plan for addressing growing debt arrearage. The plan should clearly define the role of workout agreements and foreclosures. In addition, we noted during our audit that MLC did not have written guidelines to assist in determining when to use a workout agreement and how to construct its terms and conditions. We believe written guidelines would better assure management that workout agreements are consistently and appropriately developed with correct steps regarding projects in financial difficulty.

MLC officials rely on their judgment and the staff's experience in determining the appropriate actions to be taken. They stated that their staff know the factors that will induce limited partners to invest the additional funds required by a workout agreement and whether such factors are present with respect to individual projects.

Response of MLC Officials to Audit: MLC officials stated that in many cases where a housing company has worked out its past due debts, the project's financial standing has significantly improved and certain projects, which previously have not paid any debt service, have begun to pay a portion of such debt service. MLC officials reiterated that the intent of the workout agreements was not to reduce debt arrearage. They also stated that each workout agreement is the result of many months or possibly years of negotiations and that it is not possible to construct a working model for terms and conditions. MLC officials did not comment on our recommendation to develop a strategic plan that addresses the growing debt service arrearage and the role or workout agreements and foreclosures.

Auditor Comments: The HUD interest subsidies are pledged to pay debt service on the ESDC bonds issued in 1996. These subsidies were calculated based on the debt service required under the actual 40 year mortgage loans and are approximately coterminous with the maturity of the underlying mortgages. When the bonds have to be refinanced upon maturity, the projects, with outside financial assistance no longer forthcoming, may not generate sufficient funds to make debt service payments to bondholders, possibly necessitating a State bailout to avoid default. Therefore, we urge MLC officials to focus attention on the need for a strategic plan to reduce growing debt arrearage. We believe this is consistent with MLC's stated mission to improve collections. In addition, the stated goal for workout agreements in the official statement for bond offerings is to establish projects on a sound operating basis and to improve or stabilize debt service collections.

Constructing a working model for workout agreements was not our intention. However, the guidelines we discuss within this report would be appropriate, would be consistent with good internal controls and would make staff aware of management's expectations as they apply their professional judgment and experience in developing workout agreements.

Tracking of Debt Service Arrears

Maintaining accurate and timely data on the total amounts owed for each project is essential to tracking the financial status of MLC's portfolio. MLC relies on its Loan Information Management System (LIMS) to provide such data for about 70 percent of the projects. Since MLC has experienced staff reductions, it does not have the resources to ensure that LIMS is updated with timely and accurate arrearage information for the remaining 30 percent of the projects. For these projects, MLC relies on staff to maintain arrearage data on their own microcomputer spreadsheets. MLC's various information recording system may result in inaccurate or incomplete data being transferred to Greystone when this contractor assumes responsibility for MLC's automated data processing. MLC must work closely with Greystone to ensure that complete and correct billing information for each project is readily accessible.

In their response to our observations, MLC officials indicated that they are currently working with Greystone to ensure that the new system includes correct billing information for each of the projects.

We further found that MLC's current practices and data processing capability did not permit it to readily report the entire arrearage for the portfolio at any given point in time. Instead, MLC can only provide such information on a project-by-project basis at the anniversary date of the mortgage for each project. In addition, MLC does not consider a project to be in arrears if it is covered by a current workout agreement. Therefore, the reporting that is available on MLC's portfolio may present an incomplete view of the debt arrearage for a project. We believe MLC should enhance its information system reporting capability to provide on demand identification of complete arrearage status of all projects including those covered by a workout agreement.

Response of MLC Officials to Audit: In response to our draft report, MLC officials stated that there has never been any point to report the entire arrearage for the portfolio at any given time. The added that when the portfolio has been subject to due diligence investigations for various bond issues, only the underlying mortgages, not the arrearage, and the HUD subsidies have been considered. According to MLC officials, on an

individual project basis, updated arrearage information for any date can now be provided.

Auditor Comments: We believe that reporting the complete arrearage balance is a meaningful output measurement for management to have to assess the financial status of the overall portfolio. Project-by-project information is indeed essential, but providing the big picture is also meaningful.

Billing and Collection Documentation

On the mortgage anniversary date for each project, MLC computes the monthly amounts that the management company is to be billed for the ensuring year. Greystone then sends a mortgage bill to each company. The computation for each bill is unique, taking into consideration factors such as amounts in arrears, additional funds advanced, recapitalized amounts due, and other provisions of workout agreements. MLC also prepares statistical reports on the success of their collection efforts. Adequate internal controls over these practices should include formal documentation of the methodology employed to determine the mortgage amounts billed and sufficient reporting of the results of the collection process.

However, MLC records do not explain the calculation process for each project's bill. To obtain an understanding of the calculation process, each project's history must be discussed with MLC staff. Now that its mortgage-servicing function is being assumed by an outside vendor, it is particulary important that MLC's calculation process be documented to provide proper internal controls and to avoid any misunderstandings. Documentation can also ensure consistency in the event of staff turnover.

In response to our observations, MLC officials indicated that they have directed Greystone to create billing histories for each project, based on MLC's loan documents, LIMS reports, payment histories, and information on their microcomputer spreadsheets.

MLC prepares, for management and outside parties, data showing the percentages of annual debt billings which are collected. For example, such collection data was presented on UDC's official statement of its offering for the 1996 refunding of its outstanding debt. Statistical data presented by management should be prepared using appropriate components for all computations. When preparing percentages of annual debt billings collected, MLC uses only the amount billed for the original mortgage as calculated for the Final Mortgage Determination (FMD). MLC excludes from its computations other items that have been billed,

such as Section 32 debt and debt service due on arrearage. However, MLC's computation of payments received included Section 32 advance interest, regular mortgage interest, Section 32 principal, and FMD mortgage principal. Therefore, when MLC divides the total amount of collections by only the amount of FMD billings, MLC is significantly overstating its collection percentages. For example, to report a 79.66 percent collection rate for fiscal year 1997, the total collections of $34.1 million were divided by the $42.8 million in billings for the original mortgage amounts. However, the total amount billed to the projects was actually $67.3 million, decreasing the collection percentage to 50.7 percent. For fiscal year 1996, the actual collection rate was 54.17 percent, while MLC reported a much more encouraging collection rate of 83.49 percent.

By continuing to report collection statistics based only on billings for FMD amounts, while including proceeds received for all debt components, MLC skews the perception of its success in collecting project debt.

Response of MLC Officials to Audit: MLC officials indicated, in responding to our draft report, that their intention is to report actual collections from month to month or year to year. To do this on a consistent basis, MLC officials use the FMD mortgage amounts because these amounts remain fairly constant.

Auditor Comments: We acknowledge MLC's objective to report collections over time. We would suggest, that beyond measuring this using the more constant basis of the FMD, consideration should also be given to measuring using Section 32 debt billing and debt service on arrears. Showing collections in relation to all debt billings is also an indicator of performance which potential investors in ESDC securities may wish to rely on for investment decisions.

Recommendations

1. Develop a short and long range strategic plan that addresses growing debt arrearage and the role of workout agreements and foreclosures.

2. Continue to work with Greystone to ensure that complete and correct billing information is available for each project from a common system.

Recommendations (Cont'd.)

3. Enhance information system capability so that the combined arrearage information for all projects, including those with workout agreements, can be readily obtained.

4. Require that adequate documentation is available to describe the mortgage bill calculation for each project.

5. When reporting the percentages of annual debt billings collected, consider using billing and collection data that is consistent and comparable.

Loans and Advances

As part of its responsibility for stabilizing the UDC and PFA residential loan portfolios, MLC must ensure that the physical assets that secure the project mortgages are not deteriorating. To accomplish this, MLC officials oversee the distribution of loans and advances to pay for expenses such as repairs, capital improvements and operating costs that the projects are unable to fund. The additional funding comes from several sources. For example, upon approval by MLC's Board of Directors (Board), UDC authorizes advances from debt service receipts, pursuant to Section 32 of the mortgage agreement, to pay for expenses or repairs that are needed to protect the value of the property. In addition, UDC distributes funds in the Portfolio Repair and Improvement Account (PRIA) that are generated from fees that are charged when partnership interests are transferred. The Board is later asked to reimburse this account from Section 32 funds. Also, the Housing Finance Agency (HFA) provides financing for project capital improvements through its Project Improvement Program (PIP) loans. These funds come from the proceeds of HFA bonds sold in 1993.

Nearly $145 million in loans and advances to the projects have been authorized since the inception of the Mitchell-Lama program. More than $133 million of that amount had been distributed as of March 31, 1997. We judgmentally sampled ten projects and reviewed a total of 14 Section 32 and 3 PRIA advances totaling more than $1.5 million that MLC had provided to these ten projects.

We found that MLC lacked criteria for distribution of the funds and funds were not always distributed for approved purposes.

Response of MLC Officials to Audit: MLC officials stated that, except for PIP, funds are advanced mostly for emergency situations and particular problems. Therefore, it is not possible to develop consistently applicable criteria for the distribution of the funds.

Auditor Comments: We believe that criteria for the distribution of funds is an important element of internal controls and should be achievable at MLC.

Section 32 Advances

Section 32 of the mortgage agreement provides that if the mortgagor fails to make any required payment, the mortgagee may make the payment, which is added to the outstanding debt. MLC has used this provision to advance funds to the projects for making repairs and for paying operating expenses. MLC has advanced approximately $30 million in Section 32

funds to a total of 55 projects, including $18 million to pay for compactor chute repairs and improvements. Fiscal year 1997 advances totaled $1.05 million; a significant increase over the $645,000 advanced in the previous fiscal year. MLC officials indicated that the 1997 increase was an aberration, the result of the economic downturn in the cities of Rome and Syracuse.

Although MLC officials present each Section 32 advance request to the Board for approval, they have not promulgated formal written procedures and criteria for determining which projects should receive advances, how much they should receive, or the availability of other funding sources to meet needs. Our review of 14 advances showed that:

- There was no documentation supporting the need for eight of the advances.

- For two advances made to fund repairs, there was no indication that the projects had been inspected to determine the extent of need before the lending decisions were made.

- For eight of the advances there was no indication that MLC had explored the availability of other funding sources (Three of the advances were to one project).

Response of MLC Officials to Audit: MLC officials maintained that we only reviewed the files of the Project Accountants and that we did not examine the back-up documentation.

Auditor Comments: In addition to the Project Accountant files, we also reviewed the back-up documentation maintained by MLC's Technical Services Unit.

One $170,000 advance was authorized in May 1993 to correct building code deficiencies for one project. However, in June 1997, $30,351 of this advance was used inappropriately to pay electricity bills for the project. The project did not reimburse MLC for these funds. In addition, MLC officials did not advise the Board that the inappropriate expenditures had been made. In response to our observations, MLC officials explained that the funds had been advanced as an emergency measure to avoid termination of utility service. They said they had every intention of informing the Board that the expenditure was made. For another project, MLC officials advanced without prior Board approval nearly $14,000 from the PRIA account to pay the project's real estate taxes. While the

amounts were reimbursed from the Section 32 funds with Board approval, it was not appropriate to advance funds for these purposes without the

Board's prior authorization. The prior authorization of the Board is part of the internal controls for preventing potential abuses of the funds.

Portfolio Repair and Improvement Account

In July 1984, the Board authorized MLC to create the PRIA, to make funds available to projects only for needed repairs and capital improvements. Board approval is not required to issue PRIA funds. We reviewed three payments from PRIA funds and found that for one payment, contrary to the Board's resolution, the funds were dispensed for operating expenses rather than for repairs or capital improvements. In this case, MLC officials advanced $71,389 to one project to pay electricity bills.

Response of MLC Officials to Audit: MLC officials stated that the account has been utilized occasionally for the emergency need for operating funds to avoid a utility cutoff or tax foreclosure or similar circumstance. They added that Section 32 mortgage advances were subsequently requested and approved to reimburse the account.

Auditor Comments: The account is intended to be used for operating expenses. With proper authorization, emergency needs should be met with Section 32 funds.

Project Improvement Program

HFA has committed more than $72 million to PIP loans. Nearly $40 million of these funds have been disbursed from the proceeds of HFA's 1993 bond issue. The initial decisions concerning which projects would receive PIP loans, which improvements would be funded, and how much money would be loaned, were based on applications from the projects. The New York State Division of Housing and Community Renewal (DHCR) required the projects to include, as part of their loan applications, the results of physical condition surveys. In compliance with this requirement, each project was to retain an independent architect or engineer to assess and report capital needs. DHCR then rated the capital needs described in the report and joined MLC in deciding which projects would receive PIP loans, which improvements would be funded at each project, and how much money would be loaned. Since the granting of PIP loans can significantly increase a project's debt load, MLC must verify, as part of its debt-monitoring function, the need for these additional funds.

We did not always find independent verification that these funds were actually needed. For example, MLC did not always inspect projects

before the PIP loans were issued or require the projects to submit physical condition surveys or consultant reports with their applications for PIP loans. The application form merely asked whether the project had a consultant's report and directed the applicant to attach a copy of such a report, if it existed. The approval for the loans was based on assertions on the applications. MLC officials indicated that, if their prior knowledge of the project had given them reason to consider the improvement work unnecessary, they would have investigated further by visiting or telephoning the project. However, such an additional steps were not documented as part of an audit trail for ensuring that funds were obtained for justified purposes.

To determine whether MLC had provided effective monitoring of the projects' need for these loans and the manner in which the funds were disbursed, we judgmentally sampled seven projects that had received PIP loans. We found that MLC was not adequately monitoring the conditions of the projects before it issued PIP loans, was not monitoring the disbursement of the loaned funds, and was not ensuring timely completion of the work. Our review noted the following exceptions:

- Documented site visits supporting recommendations for repairs or improvements later funded by a PIP loan were available for only two of the seven projects. For the other five projects, MLC did not provide timely independent documentation supporting the need for the PIP loan, the method used to select the specific repairs to be funded, or the manner in which the loan amounts were determined. In response to our observations, MLC officials indicate that by relying on their prior experience they can make appropriate decisions about the repairs or improvements without inspection reviews, or the documentation that we maintain is necessary. We maintain that proper internal controls require supporting documentation.

- Documented MLC project site visits had been prepared for two projects approximately four and five years respectively before the loan agreement was executed. These reports recommended repairs that would prevent further damage to the buildings, including roof replacement and the caulking and sealing of walls and joints. Although three of the recommended repairs were later included in the PIP loan agreement, MLC officials neglected, in the intervening years, to ensure that conditions did not deteriorate further. They did not perform annual inspections of the projects, leaving the conditions uncorrected for years. According to MLC officials, although the most recent documented annual inspection for one

project had been made in December 1990, the project had been inspected regularly over a three-year period. They stated that the other project had been inspected in September 1994.

- We reviewed the two most-recent PIP loan payments made by these seven projects. Payments to contractors are made as the construction work progresses. Contractors submit invoices to the project, which then submits a form to DHCR certifying that the invoiced work has been completed. After reviewing the form, DHCR submits it to MLC with a request for a co-signature on the payment-approval document. However, MLC officials do not always make an independent verification that the work has been completed. For example, construction work had been performed at six of the seven sampled projects, but MLC had performed no site inspections at three of these to verify that the improvement work had been completed in accordance with specifications. Instead, MLC relied on DHCR's document review. MLC officials explained to us that DHCR officials had instructed the projects to hire consultants to monitor work because both agreed that MLC did not have sufficient staff resources to monitor the repair work. However, MLC had no documentation indicating that the repairs at these three projects had been inspected by the consultants.

  Response of MLC Officials to Audit: MLC officials responded by restating the procedures that are supposed to be followed for the program and by asserting that such procedures have been followed.

  Auditor Comments: Our primary concern was the lack of documentation to support program compliance. Without documentation, such as the inspection reports of consultants hired to monitor work, MLC risks making payments without the appropriate work being completed timely.

Recommendations

6. Promulgate formal written procedures and criteria for determining which projects should receive advances, establishing how much should be advanced and identifying all potential funding sources.

7. Require that documentation is available for management review and oversight to support the need for each advance.

8. Before making advances to fund repairs, perform or review documented inspections to support lending decisions.

9. Inform the Board whenever it is determined that advanced amounts have been used inappropriately so that appropriate actions can be taken.

10. Do not advance PRIA funds to pay for other than repairs and capital improvements without first obtaining Board approval.

11. Approve payments for construction and repair work only after being assured that such work was performed on a timely basis, in accordance with construction schedules agreed upon in the loan agreement.

Project Inspections

A vital component of MLC's mission is to ensure the maintenance of the projects' physical integrity, which secures the mortgages in its portfolio. To monitor each project's physical condition, MLC has made its Technical Services Unit (TSU) responsible for property inspections. Such inspections should serve as early-warning indicators, alerting MLC officials to identify building deficiencies, estimate the costs of needed repairs, and ensure that the repairs are made. To provide additional oversight of the projects, DHCR supervises the activities of the companies, making periodic site visits to the projects to examine the physical condition of the properties. Proper maintenance is also important because continuation of HUD Section 236(B) interest subsidies depends on the continued habitability of the units.

Tracking and Timeliness of Inspections

When MLC was initially made responsible for performing annual inspections, it employed a much larger staff of inspectors than it does today. Despite drastic staff reductions that have made it impossible to perform annual inspections as it did in the past, MLC has not promulgated any new guidelines for the inspection function, including frequency requirements. In 1996, in connection with the refinancing of its outstanding bonded debt, ESDC asserted that MLC inspects each project at least once a year. However, MLC's log of most-recent inspection dates revealed that, between August 1, 1996 and July 31, 1997, no inspections had been completed for 72 (67 percent) of the 108 projects. For these 72 projects, the average time lag between the most-recent inspection and July 31, 1997, was 2.3 years. Some projects had not been inspected in almost six years, as indicated in the following table:

Years Elapsed Since Most-Recent Recorded Inspection					
Years Elapsed	1 to 1.9	2 to 2.9	3 to 3.9	4 to 4.9	5 to 5.9
Number of Projects	32	25	9	2	4

We selected a judgmental sample of ten projects to determine the adequacy of the inspection log. We found that while two projects had reportedly been inspected in December 1996, MLC had no evidence showing that the annual inspections were, in fact, completed. The latest inspection reports on file for these two projects were from April 1994. Because MLC's system of tracking inspections is not dependable, there may be even fewer annual inspections completed and the lag between inspections may be greater than the log indicated. These risks could lead to a lack of

awareness that serious deficiencies exist at the projects, impairing the projects' value, endangering the health and safety of the residents, and requiring repairs that are more costly than they would be if the deficiencies had been addressed promptly. In their response to our observations, MLC officials indicated that these two projects had been visited for other program purposes — to observe the conditions of the parapets and exterior walls for possible future PIP funding — in December 1996.

MLC officials stated that the staff of the TSU has been reduced considerably, from nine inspectors to three as of February 1998. Just two of the three TSU staff perform inspections. Because TSU is unable to inspect all projects annually, MLC officials said that the inspectors focus on projects that have not been examined for an extended period, are in poor physical condition, or are receiving Section 32 advances or PIP loans. However, the officials indicated that they do not always complete formal reports of these inspections.

Similarly, MLC officials did not always perform follow-up. Follow up can be just as important as the original inspections because it may be necessary to verify that previously identified problems have been corrected. For two projects, MLC had no evidence of any follow-up to resolve the conditions that had been cited in the inspection reports as needing immediate correction. For one other project, MLC had followed up on just one of the two deficiencies identified. For each of these three projects, the conditions requiring immediate action had also been noted in prior reports of inspections performed between November 1990 and September 1994. These deficiencies included such dangerous conditions as inoperable fire and smoke doors, vent and exhaust fans needing replacement, rotted deck boards, damaged steps, and broken windows. For example, inspection reports for one project repeatedly indicated that no corrective work had been done since the prior inspection. In their November 7, 1994 report, the inspectors reported that no action had been taken since the prior year's inspection. The next inspection, conducted on July 12, 1995, again indicated no improvement and cited a list of repairs that needed to be performed immediately to rectify hazardous conditions. As of December 1997, MLC had no evidence that subsequent inspections have been made at this project. Because foreclosure proceedings are in process at the site, and just 18 percent of the apartments were occupied as of March 31, 1997, MLC is not prepared to advance additional money for repairs. However, MLC should take some reasonable steps to determine that conditions are safe for the remaining tenants, and that the project's physical condition does not further deteriorate to inhibit the buildings' marketability after the foreclosure.

By not acting immediately to ameliorate unsafe conditions, MLC may impair the projects' value, raise concerns about the health and safety of the residents, and necessitate more costly repairs as conditions deteriorate further. There is also the risk that further deterioration of the projects' physical conditions will convince more tenants to vacate their apartments, thereby increasing vacancy rates.

MLC officials told us they had hoped to alleviate their inspection problems through outsourcing assignments with Greystone. With MLC's approval in July 1997, Greystone subcontracted with a New York-based firm to perform the inspections. The subcontractor began inspections in November 1997, but after a month MLC officials expressed dissatisfaction with the format of the contractor's reports, which listed recommended improvements instead of descriptions of poor conditions. The subcontractor was asked to submit reports that showed the project's physical status as well.

Response of MLC Officials to Audit: In response to our draft audit report, MLC officials emphasized that all identified dangerous conditions have been corrected in a timely manner.

Coordination with DHCR

DHCR is responsible for overseeing the ongoing activities of the housing companies. In this regard, DHCR staff make periodic visits to inspect the physical condition of projects. DHCR staff also prepare Management Field Reports that describe the inspection results.

Because of the reductions in MLC staffing, it has become very important for MLC to utilize all possible resources for monitoring the physical condition of its projects. Since the DHCR staff were reviewing many of the same elements that MLC's inspectors focus on, MLC officials decided that their inspections needed to be coordinated with those of DHCR to maximize the effective use of MLC's limited resources. Consequently, MLC officials decided to use DHCR's work as a basis for assessing risks and determining which projects to target for increased MLC monitoring. However, we questioned whether MLC was effectively coordinating its limited staff resources with DHCR because MLC staff did not even have copies of the current DHCR Management Field Reports for five of the ten projects we sampled.

Response of MLC Officials to Audit: MLC officials stated that if MLC does not have copies of a DHCR Management Field Report for a particular project, it is because DHCR did not inspect that particular project or the Report was delayed at DHCR.

Auditor Comments: MLC should follow-up on the missing Reports to obtain those that have been delayed and to ensure all inspections are accomplished.

DHCR has the authority to require the managing agents of the projects to correct deficiencies in physical conditions. Therefore, when MLC inspections discover deficiencies requiring immediate actions, MLC should inform DHCR so that DHCR can require necessary corrective actions. MLC officials advised us that they forwarded their inspection reports to DHCR. However, we found that MLC has not established a system for tracking referrals of the reports to ensure that deficiencies requiring immediate correction are addressed. Our review of the latest inspection reports for ten sampled projects found that the inspections had identified deficiencies at four projects that required immediate corrective action to address hazardous conditions. For three of these four projects, there was no evidence that MLC had advised DHCR of the inspection report results.

In their response to our observations, MLC officials indicated that, as Greystone and its subcontractor are incorporated into the annual inspection process, their inspection reports will be forwarded to DHCR. In addition, MLC officials also stated that they will create a system for tracking the status of needed repairs.

Recommendations

12. Perform timely, documented inspections of the physical conditions of the projects.

13. Perform timely and documented follow-up to resolve conditions which have been identified in inspection reports as needing immediate correction.

14. Require that subcontracted project inspection reports are completed as required.

15. Obtain and retain copies of DHCR Management Field Reports.

16. Require documentation supporting that MLC inspection reports have been forwarded to DHCR.

17. Establish a system for tracking both the referral of MLC inspection reports to DHCR and the actions taken to correct deficiencies requiring immediate attention.

Excess Cash Recoveries

For financial tracking purposes, MLC classifies projects into three categories: stabilized, non-stabilized, and workout. As of December 1997, of the 108 projects in the portfolio, 38 were categorized as stabilized (current in their debt service obligations), 23 were categorized as non-stabilized (with arrears in debt service payments) and 47 were categorized as workout (with current agreements to work out their past-due debt).

MLC monitors financial conditions of the non-stabilized or work out portfolio projects by analyzing their certified financial statements and using these analyses to determine whether the projects with debt service arrears have any funds they do not need to meet current operating expenses. If any such funds are identified, MLC should request that the projects forward such funds, referred to as excess cash, so it can be applied against past-due debt service obligations. Such actions are consistent with MLC's mission to improve debt service collections.

The process for identifying excess cash begins when MLC staff enter data from the project financial statements into the LIMS. LIMS then generates a report summarizing the financial data for each project. Two MLC staff then review these reports, the financial statements for the projects and the schedules of excess cash provided by the projects with loans in workout. This excess cash can consist of funds generated by the project operations, or it can represent deposits of larger-than-required amounts in project Operating Escrow Funds (OEF).

If the review detects any excess cash in projects that are in arrears, MLC staff contact the project and request these funds. If it is determined that the OEF account contains excess cash, the staff must seek authorization from DHCR to recover this excess cash. In the 1996 calendar year, $1.6 million in excess cash was collected from the projects as a result of MLC's review. As part of the mortgage-servicing agreement entered into in December 1996, Greystone staff are going to assume the duties of identifying and recovering excess cash.

Documentation of Procedures

We found that there are no up-to-date formal, written guidelines or criteria that staff are to follow when determining whether excess cash is available in project accounts.

In the absence of current formal procedures, MLC staff are using inconsistent methodologies for analyzing the financial statements of

projects. In some instances, the staff prepare schedules analyzing the projects' financial status; in other instances, a memo summarizing the review of the financial statement and LIMS reports is prepared. When Greystone staff become responsible for determining the existence of excess cash, they must be provided with formalized procedures so there will be no misunderstandings of the contractor's role and duties. It is also important that the process be documented adequately to assure continuity of operations in the event that any key employees leave the MLC operation.

MLC officials indicated that they will require Greystone to submit an analysis of excess cash for MLC review. They said they intend to be particularly attentive to the availability of excess project cash that can be used to pay debt service arrears.

The lack of formal procedures and the use of inconsistent methodologies have led MLC officials to make wrong conclusions about the availability of excess cash in several instances. For example, MLC staff's conclusion that one project had no excess cash was based on an incorrect schedule in the certified financial statement for the project. We found that this schedule included interest expense on the mortgage loan which exceeded the amount that MLC had actually collected from the project. Moreover, depreciation expense, a non-cash expense that does not affect the availability of funds for debt service payment, had been included in the cash expenditures. After contacting the outside auditors who had prepared the financial statements, MLC officials advised us that the interest expense was an error. When the corrected information was taken into account, MLC officials calculated that an additional $60,837 in excess cash could be recovered from the project.

Analysis of Project Records

When selecting projects for excess cash analysis, MLC's Director of Portfolio Management (Director) generally rules out those projects that have arrears and are unable to meet current obligations, as well as those projects that have long-outstanding arrears and are otherwise making current payments. The selections are reportedly based on the Director's knowledge of and experience with monitoring the projects. However, no written documentation of criteria was available to explain why certain projects were not selected for review.

For the year that ended on December 31, 1996, we found that MLC did not review the financial statements of 9 of the 70 projects in the non-stabilized and workout categories. Our review of the financial status of these nine projects showed that they were in generally-poor financial

condition and had net operating losses. We reviewed the financial statements for the two that had the highest cash deficits. One of these had a net profit of $214,215 before depreciation and amortization of deferred charges and had an operating deficit of $9,189. Regardless of whether MLC would have decided to act on the results, we believe that MLC should have included this project in their pool to analyze for the availability of excess cash because it showed a net profit.

We also found that MLC did not maintain a record showing the excess cash analyses that were performed and noting the results of those analyses. In addition, although MLC officials indicated that all analyses had supervisory review, the review was not documented. In response to our observations, MLC officials agreed to implement a log to record the completion of excess cash analyses, but they disagreed with the need to record the results of the analyses in the log.

Response of MLC Officials to Audit: MLC officials state that their goal is not to strip a project of all excess cash or to reduce a project's replacement reserve account to an unacceptably low level.

Auditor Comments: We acknowledge MLC's goal. For good internal controls, we believe that thorough documentation of excess cash reviews should substantiate for management that the proper decisions are being made.

Collection of Excess Cash

We noted that MLC did not always take the necessary steps to recover excess cash especially when projects had overages in their OEF accounts. The funding requirements of these accounts are calculated by DHCR and must be sufficient to cover annual charges for items such as real estate taxes, water and sewer charges, insurance, capital equipment replacements, painting and redecorating costs, and contingencies. We concluded that if necessary steps to recover excess cash procedures had been followed, many thousands of additional dollars could have been collected, as indicated in the following examples:

- MLC staff had identified possible excess funding of the OEF accounts for two projects as of December 31, 1996. However, MLC staff did not ask DHCR to review the situation until December 2, 1997, when we brought it to their attention. MLC officials said that DHCR officials had advised them that DHCR would continue to maintain the funds for one project but that the collection of $149,200 in excess cash from the other project would be pursued.

- One project had a balance of $1,059,752 in its replacement reserve account, well in excess of the required balance of $53,250. The project also had a balance of more than $310,000 in painting and decorating reserves. DHCR advised MLC in 1996 that the project needed both these additional funds because they anticipated that the completion of a physical condition survey would result in additional project expenditures. Although the project was meeting its minimum debt service requirements under its workout agreement, MLC officials should try to maximize the amount it receives from the project by exploring with DHCR the possibility of using some of these funds for debt service. This option can be further evaluated once the results of the physical condition survey are presented.

- The balance in replacement reserves for one project was $1,089,189, again well in excess of the required balance of $35,260. MLC had found that this project had excess funds in the prior year which had been brought to the attention of DHCR. However, DHCR officials had decided to maintain the reserve level. In view of the continuing excessive balance in this account, MLC should revisit this issue with DHCR. MLC officials indicated that they had asked DHCR to perform an analysis of the OEF figures.

- One project paid nearly $37,000 in painting and decorating expenses from its operating account, rather from its OEF, which had sufficient balances to cover the cost of redecorating. MLC did not follow up to determine whether the project could reallocate these expenditures to its OEF, thereby making the operating funds available for debt service payments. No attempt was made to recover these funds or present any justification why such attempts should not be made.

- One project reported excess cash for the three years with an excess during calendar year 1996 of $62,178. MLC made no attempt to recover these funds.

In response to our observations, MLC officials stated that they do not have the resources for pursuing excess cash as vigorously as they would like.

Recommendations

18. Establish formal, written procedures and methodologies for determining whether excess cash is available in project accounts.

19. Maintain written documentation to explain the reasons for selecting and not selecting projects for excess cash analyses.

20. Maintain a record showing excess cash analyses that are performed and the results of such analyses including supervisory review.

21. Take necessary steps to recover excess cash that may be available based upon the examples cited in this report.

Major Contributors to This Report

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January 29, 1999

Jerry Barber, Audit Director
Office of the State Comptroller
A.E. Smith State Office Building
Albany, New York 12236

Re: Draft Audit Report 97-S-33

Dear Mr. Barber:

Pursuant to your request, enclosed find four (4) copies of our response to Draft Audit Report (97-S-33) on the New York State Mortgage Loan Enforcement and Administration Corporation's administration of debt service for Mitchell-Lama projects to be included as an appendix to your final report.

Very truly yours,

Larry H. Sutton

Enclosures

N.Y.S. Mortgage Loan Enforcement & Administration Corporation
633 Third Avenue New York, New York 10017-6754 Tel 212 803 3590 Fax 212 803 3595

RESPONSE TO DRAFT REPORT 97-S-33
MORTGAGE LOAN ENFORCEMENT AND ADMINISTRATION CORPORATION
ADMINISTRATION OF DEBT SERVICE FOR MITCHELL-LAMA PROJECTS

The Auditors demonstrated a fundamental lack of understanding of the nature and purpose of MLC. Such lack of understanding is evident throughout the Audit.

EXECUTIVE SUMMARY
AUDIT OBSERVATIONS AND CONCLUSIONS

*
Note

The projects that receive interest subsidies from the United States Department of Housing and Urban Development were underwritten on that basis and therefore it was never anticipated that such projects would generate sufficient revenue to pay operating expenses and debt service obligations without such subsidies.

The Audit ignores the fact that in many cases where a housing company has worked out its past due debts, the project's financial standing has significantly improved and certain projects, which previously have not paid any debt service, have begun to pay a portion of such debt service.

The Audit states that the auditors "found that funds authorized for repairs have been used instead for operating expenses" while in reality, funds authorized for repairs were utilized only once to fund operating expenses in a case where the funds were necessary to avoid a electric turnoff by the utility company. All persons required to sign off on such advance were fully informed that such use was not for the purpose authorized by the various Boards of Directors.

MANAGEMENT OF PORTFOLIO

The projects that receive interest subsidies from the United States Department of Housing and Urban Development were underwritten on that basis and therefore it was never anticipated that such projects would generate sufficient revenue to pay operating expenses and debt service obligations without such subsidies. Such subsidies are paid directly to the mortgagee and do not affect the operating income of the projects. The "fifteen (15) subsidized projects not paying debt service" means that only the housing company's portion of the debt service, which represents approximately twenty (20%) per cent of the annual debt service requirement, is not being paid. The eight (8) projects, for which operating funds are being provided, represent, at this time, the only projects where operating expenses exceed actual cash receipts from rent.

RESTRUCTURING AGREEMENTS

While workout agreements have not reduced project arrearages, that was not the intent of such workout agreements. The primary goal of MLC is to keep the housing projects self-sufficient and, on behalf of the New York State Urban Development Corporation, the New York State Project Finance Agency and the New York State Housing Finance Agency, to maximize the

*See State Comptroller's Note Appendix B-5

collection of debt service from the projects. Such collections, in addition to the HUD interest subsidy, are used to service bonds issued by the aforesaid agencies, as well as to cover certain operating costs of such agencies and the New York State Division of Housing and Community Renewal. Increases in outstanding debt are traded against the production of current income and the production of funds necessary for project repairs for which UDC might otherwise have to advance funds.

The Auditors noted that "MLC did not have written guidelines to assist in determining when to use a workout agreement and how to construct its terms and conditions". Each project in the UDC/PFA housing portfolio is unique, with different problems and different ownership entities. It is not possible to construct a working model for terms and conditions. Each workout agreement is usually the result of many months or possibly years of negotiation.

TRACKING OF DEBT SERVICE ARREARS

The arrearage balance of the portfolio as a whole has no bearing on the ability of projects to pay debt service or operate the project. There has never been any point to report the entire arrearage for the portfolio at any given time. When the portfolio has been subject to due diligence investigations for various bond issues, only the underlying mortgages, not the arrearages, and the HUD subsidies have been considered. On an individual project basis, MLC can provide updated arrearage information for any date. At the request of the auditors, such arrearage information was produced in a short time.

BILLING AND COLLECTION DOCUMENTATION

The Auditors criticize MLC's reporting of debt service collections because such collections are not stated as a percentage of the total outstanding mortgage debt. MLC's preparation of data showing the percentages of annual debt service billings collected is not intended to be used to indicate the amount of the total outstanding debt collected but rather to allow a comparison of actual collections from month to month or year to year. In order to allow such comparison, the basis must remain consistent. Since the total debt increases, MLC utilizes the contractual FMD mortgage amounts which remain fairly constant. There is no representation that such reported percentage represents a portion of the total debt.

LOANS AND ADVANCES

Funds are advanced to projects to protect the interest of the mortgagee, and the health and safety of project occupants. Such advances are also utilized to keep the projects in compliance with HUD requirements to insure the payment of the interest subsidies to fund the debt service payments on various bond issues. Except for the Project Improvement Program, funds advanced are mostly for emergency situations and are reactions to particular problems. In such cases, while the cost of remedying the situation is considered, the cost effectiveness of the advance is not the main issue. Emergencies need to be handled immediately and because of the diverse nature of the

emergencies, it is not possible to develop consistently applicable criteria for the distribution of the funds.

SECTION 32 ADVANCES

All Section 32 advances are approved by the MLC, UDC and PFA (if required) Directors. There is always documentation supporting the need for advances. All repair requests are inspected by either MLC or the New York State Division of Housing and Community Renewal to determine need prior to the submission to the various directors for approval. In all cases the availability of other sources of funds is explored first. In conducting the audit, the auditors reviewed the individual files of MLC Project Accountants which only contained the forms necessary to actually draw down approved advances. They did not examine the backup documentation. They also did not recognize the imput of the New York State Division of Housing and Community Renewal in MLC's supervision of the portfolio. Article 2 of the Private Housing Finance Law and a Memorandum of Understanding among New York State Division of Housing and Community Renewal, MLC, UDC and PFA sets forth the specific responsibilities of MLC and New York State Division of Housing and Community Renewal. Many Section 32 mortgage advances are recommended by New York State Division of Housing and Community Renewal based upon their inspection of the project and knowledge of the lack of project funds.

PORTFOLIO REPAIR AND IMPROVEMENT ACCOUNT

The Portfolio Repair and Improvement Account was set up to handle emergency repairs where it is impossible to obtain Directors approval of a Section 32 mortgage advance on a timely basis. Section 32 mortgage advances require the approval of at least two separate Boards of Directors and sometimes three. With the consent of the MLC directors, the account has been utilized occasionally for the emergency need for operating funds to avoid a utility cutoff or tax foreclosure or similar circumstance. In such case, the Directors were subsequently requested to and did approve a Section 32 mortgage advance which was used to reimburse the Portfolio Repair and Improvement Account.

PROJECT IMPROVEMENT PROGRAM

The Auditors stated that they did not find independent verification that PIP funds were actually needed and that the approval of loans was based upon assertions in the projects' applications. MLC and the New York State Division of Housing and Community Renewal administer the Project Improvement Program on behalf of the New York State Housing Finance Agency under a Memorandum of Understanding. The applications for PIP funding are submitted to DHCR. Independent of the PIP application, DHCR requires all Projects to submit Physical Condition Surveys by an independent architect or engineer in order to adjust the project's replacement reserve requirements. The Physical Condition Surveys, when available, are reviewed by DHCR at the time of the PIP application, and utilized in determining the need for PIP funds. DHCR also reviews the projects' replacement reserve to determine if the project has sufficient funds to fund all or part of the improvements which are contained in the PIP application. Unless the requested improvement is an item, that did not require an inspection, such as smoke detectors, fireman's

service in elevators or heat conversions, the project is inspected by either MLC, DHCR or the independent architect or engineer. After all relevant information is obtained, MLC and DHCR representatives meet and agree on PIP loans for various projects.

While MLC officials themselves do not always make an independent verification that work has been completed before approving progress requisitions, in such cases verification is made by either DHCR or an independent architect or engineer hired to supervise and certify the work. Requisitions are not approved unless the completion of the work is certified by an independent architect or engineer or inspected by either DHCR or MLC.

TRACKING AND TIMELINESS OF INSPECTIONS

Although for a period of approximately a year, because of staff reductions and the focus on inspecting projects receiving PIP loans, MLC was unable to perform an annual inspection on all the projects in the portfolio, the projects were inspected by DHCR. Under the Memorandum of Understanding, it is DHCR's responsibility to insure that dangerous conditions at the projects are repaired or corrected in a timely manner. MLC only becomes involved where the project has insufficient funds to effectuate the correction of the condition. If MLC discovers a problem at a particular project either through its annual inspection or in any other manner, the matter is referred to DCHR for correction. During the period where MLC was not inspecting the projects, the projects were being inspecting by independent engineers or architects pursuant the directive of DHCR that all projects complete physical condition surveys.

All identified dangerous conditions at the projects have been corrected in a timely manner.

COORDINATION WITH DHCR

All DHCR Management Field Reports are forwarded to MLC and review when received. If MLC does not have copies of a DHCR Management Field Report for a particular project, it is because DHCR did not inspect that particular project or the Report was delayed at DHCR.

EXCESS CASH RECOVERIES
COLLECTION OF EXCESS CASH

In analyzing overfunding of a particular project's operating escrow account, the auditors constantly refer to a required balance, which is actually an annual funding requirement, and state that the actual balance is well in excess of that required balance. The balances in the projects' replacement reserves are by no means overly generous for a project of its size. It is not MLC's goal or in the interest of the mortgagee to strip a project of all excess cash or reduce a project's replacement reserve account to an unacceptably low level. The result is that if an emergency situation arises at the project it might not have sufficient funds to remedy the situation and thus require additional advances by UDC.

State Comptroller's Note

Certain matters addressed in the draft report were revised or deleted in the final report. Therefore, some agency comments included in Appendix B may